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Item 3 of the provisional agenda

INTERIM REPORT OF THE EXTERNAL AUDITOR, FINANCIAL PERFORMANCE REPORT AND PROGRAMME PERFORMANCE REPORT FOR THE BIENNIUM 2002-2003

Interim report of the External Auditor: Audit of the United Nations Industrial Development Organization for the financial period 2002-2003

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The President of the Industrial Development Board
UNIDO
P O Box 300
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Dear Sir

LETTER OF TRANSMITTAL

I have the honour to present to the Twenty-seventh session of the Industrial Development Board, through the Nineteenth session of the Programme and Budget Committee, my interim report on the audit of the United Nations Industrial Development Organization for the 2002-2003 financial period. The interim financial statements, which are included in the Interim Financial Performance Report and Programme Performance Report for the 2002-2003 financial period, have not been audited and no audit opinion is expressed thereon.

In transmitting my report I wish to advise that, in accordance with the United Nations Industrial Development Organization's Financial Regulations, I have given the Director-General the opportunity to comment on my report and that his comments have been reflected in this report.

Yours sincerely

[Signed]
S.A. FAKIE
EXTERNAL AUDITOR
AUDITOR-GENERAL OF THE REPUBLIC OF SOUTH AFRICA

Introduction

1. The audit of the United Nations Industrial Development Organization (UNIDO) was assigned to the Auditor-General of the Republic of South Africa for the 2002-2003 financial period, in terms of resolution GC.9/Dec.16 of the ninth Regular Session of the General Conference.

2. The Industrial Development Board, in its twenty-sixth session, requested the External Auditor to submit in time for the appropriate Programme and Budget Committee (PBC) session, a short interim report on the activities carried out by the External Auditor and any recommendations resulting therefrom, bearing in mind that the External Auditor can only certify the accounts at the end of the biennium (IDB. 26/Dec.2). Financial Regulation 11.10 also anticipates that an interim report be considered by the PBC.

3. Timely communication with stakeholders, at the appropriate level of aggregation, is important in ensuring good governance and accountability. Accordingly, I welcome this decision and it is with pleasure that I submit my first interim report to the Industrial Development Board, through the PBC, on the salient matters arising from the interim external audit for the 2002-2003 financial period.

TERMS OF REFERENCE

4. The audit is performed in accordance with Article XI of the Financial Regulations and the Additional Terms of Reference Governing the External Audit appended thereto. In accordance with these terms of reference, the auditor shall express an opinion on the financial statements for the financial period and report on the financial operations and various other matters set out therein.

5. The audit is conducted in accordance with the Common Auditing Standards of the Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency.

6. The audit procedures that were carried out were not performed with the intention of expressing an audit opinion on the interim financial statements that are included in the Interim Financial Performance Report and Programme Performance Report for the year ended 31 December 2002.

AUDIT APPROACH

7. A comprehensive audit approach, which integrates financial, compliance and value-added aspects, has been applied. This provides the opportunity for the External Auditor to add value to the accountability process in order to assist UNIDO in achieving its mandate in an economical, efficient and effective manner.

8. In the first weeks of my appointment, my team conducted a strategic planning visit aimed at gaining knowledge about UNIDO and developing the audit strategy for the biennium. This included substantial interaction with the outgoing External Auditors to ensure a smooth hand over of the audit and the continuation of important audit matters.

9. This was followed by an interim audit carried out at headquarters, which focused on performing intensive detailed planning aimed at obtaining a thorough knowledge of UNIDO's business and related systems. Short visits to a project and an Investment and

Technology Promotion Office were also carried out to further enhance this understanding.

10. Detailed risk assessments have been completed to ensure that in performing the financial and compliance aspects of the audit, audit resources are appropriately focused. The regularity audit will be taken forward through the performance of a pre-final audit in the last quarter of 2003 and the final audit after the closure of the financial period.

11. The internal audit function and fraud prevention policies were reviewed to take forward the issues raised by my predecessor. In addition, my team paid attention to strategic planning and related performance measurement in UNIDO at the corporate level, as well as its staff learning function as integral parts of the reform initiatives. In view of the integral part information technology systems play in UNIDO's financial operations, an information systems audit of the general control environment and system development life cycle surrounding the newly implemented Financial Performance Control System was carried out.

12. During the remainder of the financial period, we intend to focus on, *inter alia*, project management including various field visits and a review of the budgetary process. The financial statements will also be analysed with a view to providing suggested improvements in the format and disclosure thereof.

13. The IDB requested the External Auditor to include in future reports a table with the key recommendations and further requested the Director-General to complete this table by explaining the response to these recommendations by the time of the following session of the PBC (IDB.26/Dec.2). We have therefore set out as Annex A, the recommendations included in the Report of the External Auditor on the accounts of UNIDO, the Industrial Development Fund and Trust Funds for the financial period 2000-2001. The Secretariat provided its comments during February 2003 and the corrective actions will be verified during the current audit cycle.

INTERNAL AUDIT FUNCTION

Scope and approach

14. My predecessor raised certain concerns regarding the capacity of the Internal Oversight Group (IOG) to perform proactive investigations in order to identify areas of risk. It was also reported that the IOG was not in a position to perform intensive as well as extensive systematic reviews as required. The PBC and IDB noted the importance of these issues and requested the Director-General *inter alia*, to strengthen the internal oversight function (IDB.26/Dec.2).

15. The Director-General has already acted on these findings and has taken steps with a view to consolidating and strengthening the oversight and control functions of UNIDO. A Comptroller-General's Office has been established and the process of recruiting a suitable candidate, who will initially be responsible for the re-organisation of the IOG, is under way.

16. Bearing this in mind, it was decided to review the current status of the IOG with a view to providing UNIDO with constructive recommendations as it moves forward. The review sought to provide an objective assessment of the IOG against generally accepted good practice. The Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors'(IIA) were utilised to this end.

Definition of internal auditing

17. The IIA recently redefined internal auditing as follows: "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes".

18. The scope of internal auditing now also embraces wider concepts of corporate governance, risk management and control, recognising that control exists within an organisation basically to manage risk and promote effective governance.

Key findings and recommendations

19. From March 2002, the Director of the IOG was assisted by one inspector and two audit assistants. The review revealed the following key areas where the IOG's compliance with the IIA standards could be improved:

a) At the 33rd meeting of the Representatives of Internal Audit Services (RIAS) of the United Nations Organizations and Multilateral Financial Institutions held in June 2002, it was resolved to adopt the IIA's Professional Practices Framework. The IOG informed my team that they were not represented at this meeting and since the minutes of this meeting were only received in November 2002, the IOG has not yet formally subscribed to these standards. The IOG should formally adopt the IIA's Professional Practices Framework and apply these standards in performing all internal audit and oversight activities. This may be used as an opportunity to elaborate further, the terms of reference of the IOG and the nature and extent of assurance and other possible advisory services that it can provide to UNIDO.

b) The skills and resources available within the IOG should be critically analysed to determine the extent to which they can provide the required services. Action plans should be developed to address any shortfalls.

c) A risk assessment model was prepared for the 2002 year. However, it was noted that the contributions and involvement of all members of management had yet to be integrated into the risk assessment model. Communication processes between the IOG and management should be enhanced to ensure that there is a clear understanding of the role of the IOG and also to ensure that management's views are appropriately considered in the risk assessment processes.

d) Although annual departmental audit plans are prepared, it was noted that they are limited to the nature and timing of the planned audits. Details such as the frequency of audit coverage, resource requirements, duration, expected reporting dates and total time and cost budgets for each individual assignment, were not documented in the audit plan.

e) Working papers were not prepared in conformity with the standards prescribed by the IIA. The documentation did not provide evidence of the nature and extent of the supervisory reviews carried out on the work performed.

f) The IOG did not have procedures in place to formally monitor its effectiveness. Internal auditors were not required to account for actual time spent on audit activities and hence no comparisons were made between actual audit time and planned audit time. Furthermore, the IOG did not, as a rule, monitor the impact of recommendations made on the operations of UNIDO. Key performance indicators should be set and monitored, including amongst others the comparison of budgeted time with actual time, timeliness of reporting and effectiveness of recommendations made.

g) A formal quality assurance system was not in place through a review of working papers or regular internal or external quality assurance reviews.

20. The Secretariat has indicated that the concerns raised in respect of the internal audit function will be brought to the attention of the Comptroller-General, once appointed, for careful review and appropriate action.

FRAUD PREVENTION STRATEGY

21. Organisations, in both the public and private sectors, are exposed to the potential risk of fraud and corruption. Continuing progress relating to methodology in the area of governance has, *inter alia*, led increasingly to the routine development of organisation-specific fraud prevention strategies. While an exercise of this nature does not indicate the existence or suspicion of fraud in an organisation, it assists management by systematically focusing attention on each potential area of exposure and instituting appropriate safeguards to actively prevent any incidents from occurring. This is then usually coupled to the work programme of the internal auditor who serves as an important functionary in good governance and the prevention or detection of malfeasance.

22. My predecessor raised a number of issues pertaining to fraud awareness and the IOG's role in this regard. In taking these forward, it was noted that certain elements of a fraud prevention strategy were included in different rules and procedures; however, a formal and comprehensive fraud prevention strategy and contingency policy had not been developed and implemented by UNIDO.

23. It is suggested that with the introduction of the Comptroller-General function, the time may be opportune for UNIDO to embark on a structured approach. The IOG's role in the fraud prevention and contingency policy should be clarified and appropriate resources made available, including investigative expertise if necessary, for it to execute its mandate in this regard. It is recommended that the Comptroller-General consider the most appropriate actions in UNIDO's circumstances in this regard.

24. The Secretariat has stated that although a fraud prevention strategy is commendable, the applicability of such a strategy to an international organisation such as UNIDO cannot be seen in the same light as the requirements for a very large publicly quoted company. Organisations within the UN system are strictly governed by their constitutions, financial and staff regulations and rules, and other administrative instructions and guidelines and decisions by the policy-making organs. The internal and external auditors regularly check compliance with such directives. The Secretariat has also noted that such a strategy has not been implemented in any UN organisations and the introduction could have far-reaching implications. The recommendation will, however, be brought to the attention of the Comptroller-General, when appointed, for appropriate action including high-level inter-agency discussions. Furthermore, a proper risk analysis will also highlight possibly vulnerable areas, a proactive review of which will contribute to the prevention of fraud.

STRATEGIC PLANNING AND PERFORMANCE MEASUREMENT

25. Strategic planning is an essential management tool, which drives an organisation to focus its efforts to ensure that its mandate or the purpose of its existence is being fulfilled. The General Conference approved a business plan for UNIDO in 1997, which sets out the role and functions of UNIDO as well as the future activities it intends to undertake in order to achieve its mandate. The medium-term framework for achieving these goals over the period 2002 to 2005 has also been elaborated on.

26. In order to ensure the successful implementation of the business plan, predetermined and measurable performance indicators should be developed and performance against these indicators regularly monitored. While UNIDO does not currently have a formal performance management system in place, the Secretariat has recognised the need for a holistic approach that links its strategy to its activities and reports its performance against objectives set by the organisation. In this regard, a results-based management system based on the balanced scorecard approach is currently at the prototype stage. The system is intended to provide a direct link between the strategic objectives adopted by UNIDO and performance indicators, in a manner that is practical and measurable. It is noted that the Director-General's proposed Programme and Budgets for 2004-2005 contain detailed performance indicators for each programme.

27. The Secretariat should continue with exploring various options with regard to the results-based management systems as a priority.

STAFF LEARNING FUNCTION

28. The Secretariat has developed a policy on continuous learning for both headquarters and field staff, which addresses the professional development of staff as well as their personal growth. Learning is recognised as important in terms of sustainability, retaining qualified staff and developing new skills and competencies.

29. Overall, it was found that the staff learning function is well managed. In particular, it was pleasing to note that UNIDO has identified the need to address succession planning as a priority, as a large portion of existing professionals are near to retirement age. In this regard, managerial competencies have been identified and a management development programme focusing on professional excellence has been implemented for senior and middle managers. The programme has also been extended to include all professional staff. The first session for field representatives was held in February 2003.

30. The following areas for improvement were noted:

a) Divisional learning policies and plans should be developed by the respective managing directors for their divisions to ensure that any gaps identified between the professional skill requirements and current skills available are adequately addressed.

b) Periodic management reporting on the costs of learning and the extent to which learning objectives have been achieved could be used to assist management in planning future learning activities. Ratios and benchmarks could also be used to monitor the financial performance of learning activities.

c) The development of technical and functional competencies for the remaining staff should be completed as a priority.

31. The Secretariat has taken note of the above and will be taking the necessary steps to further enhance the staff learning function.

OUTSTANDING ASSESSED CONTRIBUTIONS

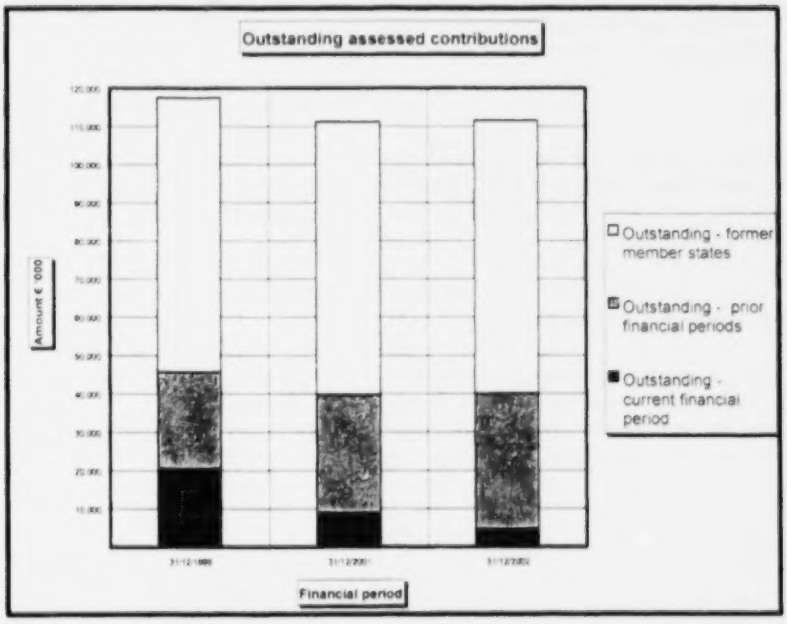
32. An analysis of the collection of assessed contributions was performed to evaluate the level of recovery of current assessments, as well as contributions that remain outstanding from prior financial periods.

33. The Secretariat is to be commended for the high collection rate of 93% attained for 2002, thus maintaining the excellent collection rate experienced over the previous two financial periods.

34. However, the increasing level of outstanding assessed contributions from prior financial periods, as reflected in Figure 1 below, is of some concern. While the outstanding balances of two former member states account for the largest portion of these arrears, the balances of certain current members are accumulating.

35. It is noted that the Secretariat has intensified its efforts to collect outstanding assessed contributions. In this regard, payment plans have been concluded with two member states and the Secretariat is in the process of negotiating payment plans with three more member states. A regular follow-up is also performed in respect of the former member states.

Figure 1: Comparison of outstanding assessed contributions over the current and former two financial periods



GENERAL INFORMATION TECHNOLOGY (IT) CONTROL ENVIRONMENT

36. The IT environment at UNIDO is increasingly pervasive in all its areas of operation as is the case with most other organisations. Continuing development is to be expected and an important focus of a sound IT environment is the extent to which it has structured measures in place to address ongoing changes.

37. UNIDO has been no exception and has recently seen the introduction of a comprehensive new accounting package, notably the Financial Performance Control System. This, by all accounts, including the comments of my predecessor, was carried out particularly successfully with regard to timing and cost. As part of my interim audit, an information systems audit of the general IT control environment, particularly surrounding this newly implemented system, was performed.

38. General controls establish a framework of overall control over the IT activities and are intended to provide reasonable assurance that the overall objectives of internal control are achieved. They serve as the foundation for the controls of all application systems and ensure the effective operation of programmed procedures including controls over the design, implementation, security, use and amendment of programs and files. If general controls are inadequate or ineffective, there is a material risk that application controls can be compromised.

39. The audit indicated a number of key areas where improvements in the general control environment would be advisable and these are summarised below:

a) **Organisational structure**

The IT function is functioning with a minimal staff complement with a particularly high level of dependence being placed on a small number of key staff members. Whilst this may be efficient in the short term, it creates concomitant risks relating not only to succession and an appropriate segregation of duties, but also with regard to prioritising operational matters, perhaps at the expense of overall controls. This should be addressed through, *inter alia*, provision of additional resources within the existing organisational structure to ensure that staff with the necessary skills to manage such systems are available at all times, without compromising the segregation of duties, to ensure continuity in the IT environment.

b) **Policies and procedures**

The existing IT strategic plan, security and network policies should be formalised and

approved. Full disaster recovery and business continuity plans should be developed, implemented and regularly tested. The various procedures in use, such as user registration and change controls, should be better documented.

c) **Operations**

The database backup and file backup procedures that have been developed should be formally documented and approved. This should include detailed instructions on how to create and restore backups.

d) **Operating systems and logical security**

Activity logs and access violation logs should be printed and reviewed regularly by management. An audit trail of the pursuant actions taken should be initiated and all reports kept as evidence of reviewing.

e) **System development life cycle (SDLC) methodology**

An SDLC methodology developed according to UNIDO's needs and requirements should be documented to govern the process of developing, acquiring and maintaining information systems and related technology. Procedures should be put in place prior to the initiation of all projects, as well as during the life cycle of the project, to identify all risks and provide safeguards. Internal audit's role in future SDLC projects should be considered.

40. The Secretariat has taken note of the general concerns about the lack of written procedures and documentation. Necessary actions will be taken, where appropriate in coordination with other Vienna-based organisations, to address the issues raised.

Acknowledgement

41. I wish to record my appreciation for the co-operation and assistance extended by the Director-General and the staff of the United Nations Industrial Development Organization during my audit.

[Signed]
S.A. Fakie
External Auditor
Auditor-General of the Republic of South Africa

Pretoria, South Africa
20 March 2003

ANNEX A

Follow-up of the recommendations made in prior external audit reports

1. Below is a tabular inventory reflecting the recommendations included in the external audit report for the 2000-2001 financial period. In February 2003, the Secretariat provided comments on the current status of implementation. The steps taken by the Secretariat are in the process of being verified and further comments will be provided by external audit in the final report, as considered necessary.

Recommendation	Secretariat's comments	
	Reply	Status of implementation
Women in the Secretariat: The Secretariat should intensively look for ways to improve the representation of female professional staff.	A more proactive approach in the area of recruitment and career advancement of female staff has been adopted, and significant improvements have already been achieved.	Recommendation accepted and implementation is ongoing.
Subcontracting: Subcontracting should be given more emphasis in technical cooperation projects, with due consideration of the individual situation.	This issue continues to be discussed extensively taking into account the staff's technical competencies. This issue now forms part of the procurement workshops being held at headquarters.	Recommendation accepted and will be implemented, where feasible.
Establishment of a non-project-specific fund: The establishment of a non-project-specific fund could enhance project design and project evaluation.	To date no donor has agreed to provide resources to establish such a fund.	Recommendation accepted and efforts will continue to obtain such funds.
Package deals with suppliers: UNIDO should endeavour to enter into package deals when possible.	Package deals are being considered when feasible. Procurement staff are aware of the issue and procurement requirements for 2003 are being analysed to identify clusters of identical products. Package deals are concluded for some headquarters requirements to achieve economies.	Recommendation accepted and will be implemented, where feasible.
Evaluation of offers: More aspects should be considered when offers are evaluated. Performance of the suppliers should be monitored and evaluation data used when considering new offers.	The performance record of suppliers will be considered as part of the evaluation of offers. Existing performance evaluation forms will be adjusted to include additional parameters. The intranet roster of suppliers and service providers is being updated to reflect, *inter alia*, supplier performance records.	Recommendation accepted and is in the process of being implemented.
Socio-economic aspects in projects: Soft factors should be reflected in project design. Experts should be instructed on country- specific socio-economic aspects.	This is taken into account wherever possible within the guidelines prescribed by the donor.	Recommendation accepted and implementation is ongoing.

Recommendation	Secretariat's comments	
	Reply	**Status of implementation**
Harmonisation of donor procedures with respect to project budgets: UNIDO should discuss with the donor community the use of standard procedures and increased flexibility on budget lines.	Continuous dialogue takes place between UNIDO management and donors when negotiating agreements.	Recommendation accepted and implementation is ongoing.
Delays in project implementation: Project design should reflect anticipated delays. A careful planning of project activities should be undertaken and alternative work plans on project activities should be considered. Moreover, sanctions should be foreseen and applied when project parties do not fulfil their duties.	The introduction of an Implementation Working Agreement between recipient companies and UNIDO clearly specifies the responsibilities of each party involved.	Recommendation accepted and implementation is ongoing.
Control of supplies on project site: UNIDO should control on site whether supplies of sophisticated items are in line with contracts.	Where UNIDO has field representation, they will be involved. Where field representations are not available, independent inspection companies may be contracted subject to the availability of funds.	Recommendation accepted and implementation is ongoing.
Provision of handbooks and manuals: Suppliers of conversion equipment should be required to provide handbooks, manuals and even training in the relevant domestic language and not only in the English language.	The requirement to provide technical documentation in a local language is included in specifications upon request of the counterpart and subject to the availability of funds.	Recommendation accepted and is being implemented, where requested and within available funds.
Human resource problems faced by the Montreal Protocol Branch: UNIDO staff should not be engaged as consultants.	If required technical expertise is available in-house, staff are detailed for short periods to projects to provide the expertise, rather than recruiting outside consultants for such work.	Recommendation not accepted as current practice is seen as an efficient use of resources available to UNIDO.
Evaluation of projects implemented under the Montreal Protocol (MP): UNIDO should carry out its own evaluations and should establish, in interaction with the MP Secretariat, a strategy on evaluation and its financing.	Upon completion of every MP project, mandatory and comprehensive project completion documentation is prepared. The Multilateral Fund Secretariat controls the quality, completeness and timeliness of this documentation. The Multilateral Fund provides no financing for additional project evaluation.	Recommendation not accepted, as the existing evaluation mechanism is considered adequate.

Recommendation	Secretariat's comments	
	Reply	Status of implementation
Assistance to economically non-viable companies: The MP Secretariat and the implementing agencies should take into account such considerations as economic viability of companies before a project is approved and/or implemented.	The approval of investment projects is governed by the rules of the Multilateral Fund. Every project is screened by the government prior to its submission for approval. The screening process also involves preliminary evaluation of the overall viability of the recipient company. After approval of the project, the UNIDO Project Manager once again verifies the status of the company.	Recommendation accepted and implementation is ongoing on individual projects.
Impact and sustainability of the project: Appropriate assistance related to, for example, market access, sales/export promotion, access and use of market information and price calculation in a market economy should be included in future technical cooperation projects.	Management will include this consideration whenever possible in the formulation of future projects.	Recommendation noted and implementation is ongoing.
Cluster approach in projects: UNIDO should refrain from assisting only a single company and give preference to a cluster approach.	Management will include this consideration whenever possible in the formulation of future projects.	Recommendation noted and implementation is ongoing.
Contractual arrangements: Contractual arrangements should be made for a situation where the recipient fails to provide the required inputs and a lack of commitment becomes apparent.	Prior to the start of every project an agreement is signed between the recipient and UNIDO, which is submitted to the respective governments. In cases where extended delays or lack of clear commitment from the side of the counterpart is nonetheless experienced, clarification is sought from the counterpart.	Recommendation accepted and implementation is ongoing.
Code of ethics and staff rotation: A code of ethics should be implemented and a staff rotation introduced in areas which are by nature fraud-endangered.	The Standards of Conduct in the International Civil Service, which have recently been revised, have been issued to all staff. Rotation modalities are being finalised taking into account institutional memory and need for core staff.	Recommendation accepted and implementation is ongoing.
Checks on consulting contracts: The checks on consulting contracts and on behaviour in the field should be improved. The reporting system on allegations should be clarified.	Management is taking necessary action to improve checks on consulting contracts and reporting on allegations. A detailed work plan will be prepared once the new Comptroller-General has been appointed. An e-mail hotline to the IOG was established some time ago to receive anonymous allegations. Periodic reminders of this avenue of reporting are sent to staff.	Recommendation accepted and implementation is ongoing.

Recommendation	Secretariat's comments	
	Reply	Status of implementation
Fraud investigations: The IOG should be strengthened with a qualified investigator. Fraud-oriented investigations by the IOG should be reported to the External Auditor.	Action to strengthen this function has been formally elaborated and a Comptroller-General is under recruitment. Fraud-oriented investigations are routinely reported to the External Auditor.	Recommendation accepted and implementation is ongoing.
Stocktaking system: Stocktaking at headquarters should be improved. Responsibilities for stocktaking at field offices and for technical cooperation projects should be clarified.	Stocktaking is currently in progress. In December 2002, a list of property was distributed to all field offices, including technical cooperation projects, for verification.	Recommendation accepted and is in the process of being implemented.
Write-offs: More detailed information on the write-offs of losses of property should be disclosed in the financial statements.	Detailed listings of this type of information are available.	Recommendation accepted and information will be provided in the 2002-2003 biennium financial statements.
Repayment of voluntary contributions: Improvements in future trust fund agreements are advisable in order to clarify the conditions under which repayments of voluntary contributions can be made.	Management will continue to identify ways to improve such agreements when negotiating with donors. It is, however, not practical to list all repayment possibilities or eventualities.	Recommendation accepted and implementation is ongoing
Evaluation of Global Forum activities: Evaluations should ensure that strategic outputs of Global Forum activities are incorporated into UNIDO's work.	Outputs are regularly reviewed for incorporation into UNIDO's work.	Recommendation accepted and implementation is ongoing.
Improvement to quality management: A comprehensive system of quality management should be implemented.	Management is committed to a system of quality management and several guidelines have already been issued. Further guidelines are being developed or updated. The Programme and Budgets for 2004-2005 will also provide information on performance indicators.	Recommendation accepted and implementation is ongoing.
Catering service: The principle of the VIC Catering Services as a commercial and self-sustaining operation may be realised after recalculation of the sales prices for meals and drinks, taking into account all relevant costs incurred.	Considerable improvements have already been implemented by the management to reduce subsidies to the extent possible while maintaining the low price levels of food and drinks and ensuring maintenance of food quality. Further review is ongoing.	Recommendation accepted and implementation is ongoing.

2. The following significant issues still remain outstanding from the report of the External Auditor for the 1998-1999 financial period:

Recommendation	Secretariat's comments	
	Reply	**Status of implementation**
New York and Geneva offices: Improved management processes should be implemented in the New York and Geneva offices.	Terms of reference and functions of these offices are contained in Director-General's Bulletin DGB(O).86/Add.9 of 15 February 2002. Full details of the activities of both offices during 2002 are contained in Chapter I of the Annual Report, 2002 (IDB.27/2-PBC.19/2) and reflect to a large degree the involvement of these offices in a wide range of activities.	Recommendation noted and implementation is ongoing.
After-service health insurance liabilities: UNIDO should consider using the financial windows of opportunity to commence funding this liability by applying the principles developed in private sector accounting.	This is a highly complex issue having large funding implications. According to an actuarial study to determine the financial impact of after-service health insurance, the level of UNIDO's unfunded liabilities as at 31 December 2002 amounted to € 47.3 million. UNIDO is therefore of the opinion that a UN system-wide approach would be more appropriate than a stand-alone solution. This issue is actively being followed up to find an appropriate solution to address the funding liability within the context of the UN system.	The issue is acknowledged and a UN system-wide solution is being sought. The lead agency on this issue established by the High-Level Committee on Management Financial and Budget Network (HLCMFB) is the UN. On 21 February 2003, the UN informed UNIDO that the study is still under progress and is expected to be completed during 2003. UNIDO will keep its policy-making organs informed of further developments in this regard. Should no developments be forthcoming, proposals will be made to the next session of the Programme and Budget Committee, as requested by the IDB in decision IDB.26/Dec.2(i)(i).